

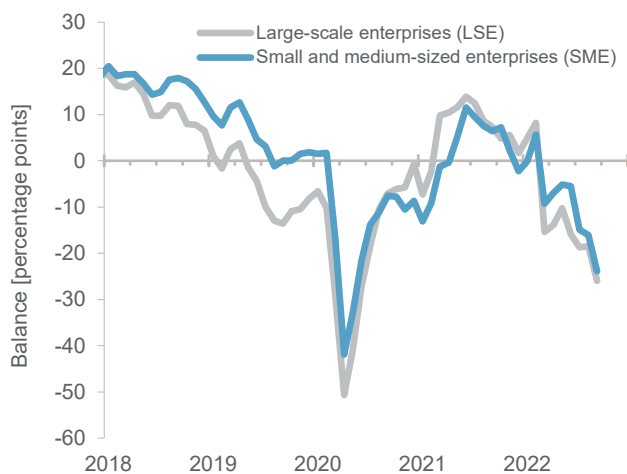
»»» The recession has begun; business expectations are nearing their all-time low

11 October 2022

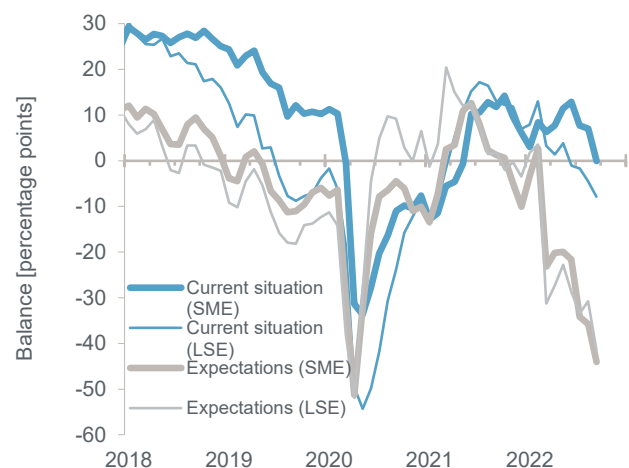
Author: Dr Klaus Borger, phone +49 (0)69 7431-2455, klaus.borger@kfw.de
Press contact: Christine Volk, +49 (0)69 7431-3867, christine.volk@kfw.de

- SME business sentiment has dropped further
- Situation assessments are now merely average, expectations extremely pessimistic
- All economic sectors are in the grip of a downward spiral
- Sentiment among large enterprises has also worsened significantly

KfW ifo Business Climate Index



KfW ifo sentiment components



Source: KfW Research, ifo Institute

A frosty start to autumn for SMEs

It has been a frosty start to autumn, at least where SME sentiment is concerned. The constant flow of bad news around the war and the energy crisis caused SME business confidence in September to plunge nearly three times the rate of a typical monthly variation. It fell by 7.8 points and now sits at -23.9 balance points, the lowest level in 28 months. Both sentiment components deteriorated significantly:

- Business situation assessments dropped by 7.1 points to -0.1 balance points and are now just barely below the historic average. In the third quarter they decreased by a noticeable 12.4 points overall, which points to a contraction of GDP already in the summer.
- Business expectations are moving increasingly closer to the all-time low of April 2020, shortly after the outbreak of the coronavirus crisis, falling by 8.3 points to -44.1 balance points. Their eyes turned to the winter half-year, businesses

far and wide are deeply worried about exploding energy costs and collapsing demand.

Sentiment has cooled considerably in all sectors

The downward spiral in business confidence gripped all main economic sectors in September; the mood among small and medium-sized enterprises everywhere is clearly deteriorating. The lowest sentiment was reported by the retail sector, whose business success is more dependent on household consumption expenditure than all the sectors under consideration (-38.1 balance points; down by 6.5 points since August). Wholesalers are in second but last place (-30.7 balance points; down by 4.3 points). Both segments of commerce are deeply concerned that the very high inflation rates will massively curtail purchasing power and that households will also prefer to hold on to their money as a precaution. The manufacturing sector is in midfield (-27.7 balance points; down by 6.5 points) and increasingly pessimistic about export prospects (-20.2 balance points; down by 3.9 points). At the beginning of autumn, the least bad sentiment was recorded in

services (-18.8 balance points; down by 7.3 points) and construction (-15.3 balance points; down by 6.4 points). Long a reliable growth engine, the construction sector is now increasingly suffering from price surges for energy and materials and rising financing costs.

Sentiment among large enterprises is also plummeting

Sentiment among large enterprises nosedived again in September, after just barely remaining steady in the previous month (-26.0 balance points; down by 7.5 points). Whereas their business expectations were roughly as negative as those of SMEs (-41.4 balance points; down by 10.6 points), large enterprises again rated their current business situation worse (-7.9 balance points; down by 3.4 points). A sector comparison shows that even among large enterprises, sentiment remains highest – relatively speaking – in the construction industry (-18.3 balance points; down by 9.5 points) and at some distance lowest in retail (-40.1 balance points; down by 7.6 points), with all sectors reporting sharp drops since August.

Price expectations are rising again from a high level

There is little chance of improvement for the consumption-related economic sectors. On the contrary, the consumer price inflation rate reached double digits already in September, after relief measures such as the 9-euro ticket and the fuel discount ended (+10.0% year on year) and sales price expectations now rose again from a high level in both company size classes after moderate drops in the preceding months (SMEs: +5.8 points to 42.9 balance points; large enterprises: +3.8 points to 39.4 balance points). Sales price expectations are the only indicators of the KfW-ifo SME Barometer with a positive sign in September – and that, too, is bad news. Pressure on household purchasing power remains unabated for now. At the same time, the boost on consumption provided by the labour market is waning further (employment expectations among SMEs: -1.9 points to 0.8 balance points; large enterprises: -6.4 points to 2.3 balance points).

Germany will be in recession for at least three quarters

The core message of the KfW-ifo SME Barometer is that Germany is slipping into recession. GDP probably contracted already in the summer, and at least two further negative quarterly rates will follow. The deteriorating business situation assessments presented across all sectors on average over the months of July to September from the preceding quarter suggest that economic output contracted in the summer, while the broad pessimism expressed in the responses from businesses of all size categories is an indicator of the dismal outlook on the winter half-year 2022/2023. The terrible mood, especially in consumption-related sectors, and the depressed expectations everywhere illustrate what challenges Germany currently faces in the light of exploding costs of living and energy prices as well as the uncertain supply situation, particularly for natural gas. Winter is coming, and the first priority is to get through the cold season as unscathed as possible. Even though a recession is practically certain, we remain confident that it will end up being less severe than the depressing mood suggests. Especially with expectations being close to their historic lows, factors that are likely to play a role in addition to the legitimate concerns over energy cost pressure and dwindling sales prospects are high levels of anxiety fuelled by ongoing twists and turns in the war, such as the sabotage of the Baltic Sea pipelines, the annexation of Ukrainian territory and Russia's threats of nuclear attacks. The recently announced fiscal support package of EUR 200 billion has the potential to relieve businesses and households from some of the cost pressure. The electricity and gas price caps in particular are likely to bolster consumption noticeably. We still believe our GDP forecast of -0.3% for 2023 to be plausible, although the downward risks are high and growing.

KfW-ifo SME Barometer in figures

Balance [Percentage points]*		Month/Year							m-o-m	y-o-y	3m-o-3m
		Sep 2021	Apr 2022	May 2022	Jun 2022	Jul 2022	Aug 2022	Sep 2022			
Business climate											
Manufacturing	SME	8.8	-10.2	-9.9	-10.7	-18.4	-21.2	-27.7	-6.5	-36.5	-12.2
	LSE	14.3	-8.4	0.4	-8.4	-10.5	-15.1	-18.6	-3.5	-32.9	-9.3
Construction	SME	18.1	-13.7	-7.4	-4.2	-10.7	-8.9	-15.3	-6.4	-33.4	-3.2
	LSE	9.8	-20.0	-9.8	-8.1	-16.4	-8.8	-18.3	-9.5	-28.1	-1.9
Retail trade	SME	5.7	-4.8	-7.2	-19.1	-28.8	-31.6	-38.1	-6.5	-43.8	-22.5
	LSE	-6.9	-27.9	-26.9	-36.4	-35.7	-32.5	-40.1	-7.6	-33.2	-5.7
Wholesale trade	SME	8.1	-5.5	-8.9	-13.8	-20.7	-26.4	-30.7	-4.3	-38.8	-16.5
	LSE	7.7	-9.8	-8.5	-17.8	-24.0	-28.1	-32.5	-4.4	-40.2	-16.2
Services	SME	3.5	-5.5	-1.0	1.1	-9.3	-11.5	-18.8	-7.3	-22.3	-11.4
	LSE	3.4	-18.7	-17.6	-17.4	-22.0	-18.2	-30.2	-12.0	-33.6	-5.6
Germany	SME	6.4	-7.0	-5.2	-5.5	-14.9	-16.1	-23.9	-7.8	-30.3	-12.4
	LSE	7.3	-13.9	-10.3	-15.9	-18.7	-18.5	-26.0	-7.5	-33.3	-7.7
Current situation	SME	11.8	7.7	11.4	12.9	7.7	7.0	-0.1	-7.1	-11.9	-5.8
	LSE	13.0	1.4	3.8	-1.1	-1.7	-4.5	-7.9	-3.4	-20.9	-6.1
Expectations	SME	1.2	-20.2	-20.0	-21.7	-34.2	-35.8	-44.1	-8.3	-45.3	-17.4
	LSE	1.8	-27.3	-22.8	-28.8	-33.4	-30.8	-41.4	-10.6	-43.2	-8.9
Employment expectations	SME	11.8	9.7	10.1	8.5	4.0	2.7	0.8	-1.9	-11.0	-6.9
	LSE	13.4	11.3	14.8	11.5	10.4	8.7	2.3	-6.4	-11.1	-5.4
Sales price expectations	SME	25.9	52.8	45.8	42.4	37.9	37.1	42.9	5.8	17.0	-7.7
	LSE	27.4	52.0	50.3	42.3	34.9	35.6	39.4	3.8	12.0	-11.6
Export expectations of manufacturing	SME	6.1	-7.1	-9.3	-8.6	-12.1	-16.3	-20.2	-3.9	-26.3	-7.9
	LSE	13.3	-5.8	-2.0	-3.5	-9.1	-9.8	-10.7	-0.9	-24.0	-6.1

Source: KfW Research, ifo Institute

Explanations and abbreviations:

*Seasonally and mean adjusted (long-term mean since January 2005 = 0)

S(mall and) M(edium-sized) E(nterprises).

L(arge-)Scale E(nterprises).

Change in percentage points m(onth)-o(ver)-m(onth).

Change in percentage points y(ear)-o(ver)-y(ear).

Change in percentage points 3 m(onths period)-o(ver)-3 m(onths period).

Revisions relative to previous publications may occur due to seasonal and mean adjustments as well as rounding. The KfW-ifo SME Barometer was fundamentally revised for the reporting month of April 2018 (new aggregation process, inclusion of services, start of time series now 2005 instead of 1991, consideration of export expectations, discontinuation of regional indicators for western and eastern Germany). Publications prior to and from April 2018 are therefore comparable to a limited extent only.

Construction and interpretation of the KfW-ifo SME Barometer

The KfW-ifo SME Barometer indicator family is based on a scale-of-enterprise evaluation of the ifo economic surveys which are used to calculate, among other things, the well-known ifo Business Climate Index. Each month about 9,500 enterprises from trade and industry, construction, wholesale, retail and services (without the banking and insurance sectors or the state) are polled on their business situation, among them some 8,000 SMEs. Enterprises are generally classed as small to medium-sized if they employ a workforce of not more than 500 and record an annual turnover not exceeding EUR 50 million. For a more accurate analysis, however, these quantitative distinctions have to be drawn more narrowly for retail trade (maximum annual turnover of EUR 12.5 million), the building and the construction industry (up to 200 employees) and services (maximum annual turnover of EUR 25 million). All enterprises that exceed at least one of these thresholds are classed as large-scale enterprises. The KfW-ifo SME Barometer reports the balance of current business assessments (percentage of positive answers less percentage of negative answers), the balance of business expectations for the next six months, ascertained in a similar way, and the inferred mean average value for the business climate. Moreover, the enterprises' employment and domestic sales price expectations and – exclusively for manufacturing – export expectations are also captured as balance figures for the next three months. All time series are seasonally and mean adjusted. The zero line therefore marks the long-term 'cycle-neutral' average since January 2005. Indicators above (or below) zero point to an above average or favourable (below average or negative) business situation.